2020 Foresight

The year ahead in corporate governance

2020 marks the start of a new decade and, with it, new challenges for directors and company secretaries. Our annual update explores some of the key issues that lie ahead and what they mean for corporate governance professionals.

Across the globe, organisations face greater pressure from escalating economic and environmental conditions that require decisive action backed up by robust plans.

Despite greater complexity, rising regulatory and public expectations mean that getting the basics right is non-negotiable. Boards are accountable for the culture and conduct that underpin ongoing compliance. Those who fall short can expect more severe consequences and the risk of becoming front page news.

Technology, processes and insights are the foundation of modern governance, enabling boards to effectively navigate this changing landscape.

Diligent

Corporate social responsibility

A new wave of investor activism, calls for a broader corporate purpose, and legislation focusing on ethical supply chains are all driving an increased emphasis on organisations' social behaviour. Regulatory compliance is increasingly seen as a minimum standard, putting pressure on boards to meet rising public expectations.

There's much more to social responsibility than a handful of community support programs and a glossy report.

Fair, ethical and respectful interaction with customers, workers and suppliers is at the heart of responsible behaviour. It comes down to an organisation doing the right thing by people. While that sounds simple, success is a matter of sustained, consistent action at every level.

When something goes wrong – and it's inevitable that it will – an organisation's response is critical. Denial, defensiveness and delay rarely produce a positive outcome.

Recent regulatory investigations and the Royal Commissions into financial services and aged care have exposed widespread wrongdoing. Failures that have been attributed to a handful of bad apples or a one-off system malfunction have all too often been indicative of systemic issues beneath the surface.

The dialogue between directors and management is changing, with executives facing more challenges by boards and no longer being relied on as the sole source of information. At the same time, boards are grappling with the boundaries of their non-executive roles.

Q. If this was more than an isolated incident, how would we know about it and what would we do to put it right?

Climate Change

The start of summer has already seen millions of hectares burned by bushfires across Australia.

Worldwide, record numbers of people were displaced from their homes due to extreme weather events in 2019. Next year is seen as a watershed for meaningful action to address the growing climate crisis.

The first five-year milestone under the UN's Paris Climate Agreement will be reached in 2020, requiring signatories to update their plans to limit global warming.

Meanwhile, Australia has been ranked last out of more than 50 countries on climate change policy according to the latest Climate Change Performance Index (CCPI), receiving a score of zero percent. Policy was one of four categories assessed in the CCPI, with Australia coming 56th overall with a score of 30.75%.

The report noted that "Australia receives the lowest rating in this year's Climate Policy rating as experts observe that the newly elected government has continued to worsen performance at both national and international levels."

Prominent voices, from teenage activist and Time's person of the year, Greta Thunberg, to legal heavyweight and Royal Commissioner, Kenneth Hayne, are speaking up about the collective responsibility.

At home, many companies have struggled with the Australian government's lack of a bipartisan policy on climate change. Directors rate climate change as the top priority for the government over the long-term, and second only to energy policy in the short-term, according to the Australian Institute of Company Directors' most recent Director Sentiment Index (AICD DSI).

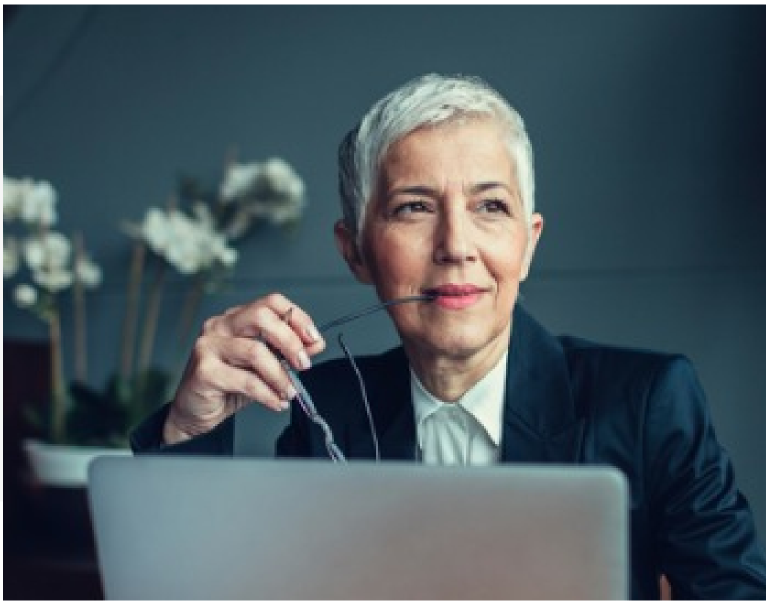
Across industry sectors and ownership structures, boards must step up and demonstrate how they will help fight the battle against climate change.

The Centre for Policy Development brought together business and government leaders in November 2019 to consider Australia's response to climate risk. It concluded that:

- Boards must consider climate change more broadly than just a non-financial risk.
- Directors need more visibility and better information on climate risk.
- Organisations should increase collaboration to address climate risk, including with government and across the public sector.

Q. What are the longer-term consequences of delaying investment in making our business more environmentally sustainable?

"... the consequences of climate change are upon us now, and decision makers across the Australian economy have a clear and increasing obligation to address the risks and opportunities it presents."
Centre for Policy Development (CPD), Business Roundtable on Climate & Sustainability



Geopolitical change

The world will be watching as the US prepares for its next presidential election, scheduled for 3 November 2020. Its outcome will influence economic relationships around the world and whether the current trend towards greater nationalism is likely to continue.

Following months of civil unrest and pro-democracy protests, Hong Kong will also face elections next year. Elsewhere in Asia, Singapore and South Korea will also go to the polls while, closer to home, New Zealanders will decide whether Jacinda Ardern returns for a second term as Prime Minister. Meanwhile, the continuing Brexit saga remains unresolved, leaving a question mark over trade between the UK and the rest of the world.

Economic headwinds

Mounting external pressures are confronting a wide range of organisations. Australia's economy continues to be sluggish, with interest rates at record lows, high levels of household debt, and inflation remaining below target.

Directors are keenly aware of the growing risk, with global economic uncertainty ranking as the top economic challenge facing Australian business, according to the AICD DSI.

Economic sentiment among directors has declined since the previous index, with net negative expectations for the Australian, Asian, European and US economies.

However, despite those concerns, a significant proportion (43%) of directors expect their own organisation will expand in the next year.

The fact that a generation of Australians has never experienced a recession goes some way to accounting for this optimism.

This is coupled with a major lack of international experience on Australian boards. Only 3% of directors included it in their skills in the AICD's 2019 report, Driving Innovation: The Boardroom Gap.

Q. Do we have the plans and skills we need to steer our organisation through a recession?

Non-financial risks

While democratic processes will have a major bearing on economic stability, boards will continue to turn their minds to a wider slate of risks beyond financial matters.

Governance of non-financial risks will continue to be a focus area next year as organisations seek to increase the maturity of their oversight and management. That includes effective monitoring of compliance with non-financial risk appetite parameters and identifying appropriate metrics to review ongoing performance.

Boards face a catch-22 situation when it comes to rewarding non-financial risk management.

Remunerating effective non-financial risk management when an organisation falls short of its financial goals is widely frowned upon by investors. Conversely, strong financial performance is frequently rewarded even when other areas are deficient.

Irrespective of the strategic, cultural and regulatory importance attributed to non-financial risks, this disparity means money still talks when it comes to motivating change.

Embedding the cultural imperative that the right outcomes only matter if they result from the right actions remains a challenge for many boards.

Q. How do we create meaningful accountability for better non-financial risk management?

Directors' responsibilities

A year on from the Hayne Royal Commission, regulators and investors will expect tangible evidence of genuine change at financial services companies. However, continuing high-profile governance failures suggest the pace of change is not fast enough.

Early statements by regulators suggest growing impatience and greater preparedness to take strong action despite the failure of some recent legal cases Increased penalties introduced this year for breaches of directors' duties and rising costs of D&O insurance mean this issue is front of mind for boards.

The court of public opinion has claimed increased numbers of chairs, non-executive directors and CEOs over major corporate governance issues.

There is greater expectation for accountability at the highest levels of an organisation and an increased tendency to question the board's involvement when unacceptable conduct occurs.

Q. How do we create meaningful accountability for better non-financial risk management?

Information that delivers insight

The average size of board reporting packs continues to grow in response to increasing director responsibilities and greater complexity. But more information doesn't necessarily equal better information.

Boards are swamped with enormous amounts of reading material ahead of meetings, making it hard to identify critical issues.

Directors, executives and governance professionals need to work together to shrink pack sizes while magnifying the focus on what matters most.

That involves distilling high volumes of data, going beyond analysis to deliver meaningful insight that supports board oversight and decision-making.

As well as receiving relevant, timely reports from management, there is also a greater need to bring a wider range of perspectives into the boardroom. Information from external sources provides independence from management and amplifies the voices of stakeholders.

Q. What information provides the greatest insight into how well the organisation is achieving its strategic goals and managing its key risks?

Board induction and education

In a fast-moving business landscape, it's essential that new board members can rapidly become familiar with their organisation so they can contribute effectively. However, while many areas of governance are becoming more refined, directors still often comment that their onboarding processes leave significant room for improvement.

A large proportion of induction materials typically comprises information on governance frameworks and policies rather than substantive strategic matters and organisational performance.

Without broader context, previous board and committee minutes may provide static snapshots that give an incomplete picture of the depth of the board's deliberations. New appointees can benefit from an experienced board colleague or governance professional to provide further insight as part of the on-boarding process.

In parallel, a shift towards more detailed minutes regarding the nature of key issues to management is continuing to take place.

Directors and company secretaries can expect to spend more time preparing and reviewing minutes to ensure they stand up to scrutiny.

Director induction, rather than being a stand-alone process, should form part of an overall board training program.

Regular informal briefings and presentations are important to keep boards updated on emerging organisational issues and industry trends, particularly regarding non-financial risks.

Q. What do directors need to know more about and how can that information be provided well before those issues arise in the board approval process?

Timing is everything

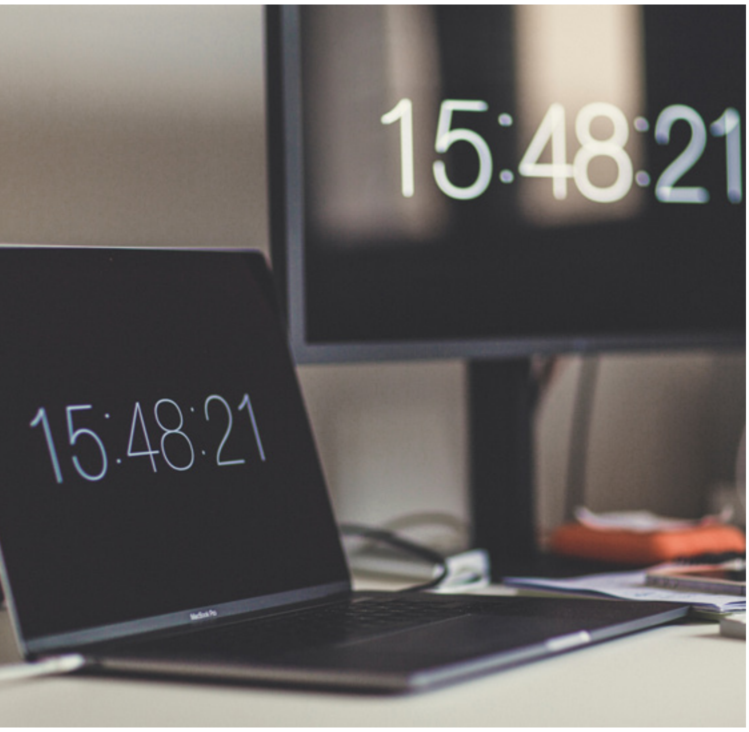
Excessive focus on the short term is one of the highest barriers to greater productivity. Concentrating on shareholder returns from one reporting cycle to the next also contributes to a risk-averse culture on boards.

Companies that focus on a more distant horizon are better placed to satisfy investors and stakeholders.

Setting strategies that are designed to go the distance is critical. Slashing costs and cutting workforce numbers may provide a rapid boost to the bottom line but their longer-term consequences can include ageing infrastructure, inadequate systems and under-resourcing.

The rapid pace of external change can catch companies off guard, exposing their vulnerability. This can result in ongoing compliance issues, major rectification costs, and the potential for significant reputational damage.

While the pace of change continues to accelerate, a long-term focus positions boards to deliver lasting value.



In it for the long haul

Diligent has developed a modern governance system to help organisations of all kinds adapt and thrive in an evolving landscape.

We enable directors and executives to collaborate electronically, anywhere in the world at any time of day.

Our solutions provide intuitive functionality combined with robust security, supporting seamless communication. We continually invest in developing new features to support boards and governance professionals with the new challenges they face.

Diligent has been providing specialist corporate governance solutions for more than a decade, delivered with award-winning customer service tailored for directors' expectations.

For more information or to request a demonstration, please contact us:

Phone: **1800 646 207**
Email: **info@diligent.com**
Visit: **diligent.com/au**

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